

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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BAY STATE GAS COMPANY)	D.T.E. 02-72
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INITIAL BRIEF OF
BAY STATE GAS COMPANY

I. INTRODUCTION

On November 6, 2002, pursuant to G.L. c. 164, §§ 76, 76A, 94 and 220 C.M.R. 6.06, Bay State Gas Company (“Bay State” or the “Company”) filed with the Department of Telecommunications and Energy (“DTE” or the “Department”) a request for authorization to (1) use an internal fuel financing vehicle in place of Bay State’s Fuel Purchase Agreement with BayNor Energy, Inc. (“BayNor”) and other related agreements (“BayNor Arrangement”) and (2) continue to collect the financing charges associated with its gas inventory through its Cost of Gas Adjustment Clause. Pursuant to order of notice duly issued, the Attorney General filed a notice of intervention. On December 12, 2002, the Department conducted public and evidentiary hearings at its offices, at which Bay State sponsored the testimony of Vincent Rea, Director of Treasury and Corporate Finance for NiSource Corporate Services, Inc. (“NCSC”) and Assistant Treasurer for Bay State. The evidentiary record consists of the Company’s initial filing and responses to information requests issued by the Department Staff and the Attorney General. Pursuant to the established procedural schedule, Bay State Gas Company hereby submits its initial brief.

II. OVERVIEW OF BAY STATE'S PROPOSAL

Bay State has proposed to use the NiSource Money Pool ("Money Pool") as its inventory financing vehicle instead of the expiring BayNor Arrangement in order to take advantage of lower fuel inventory financing costs that may be achieved through use of the Money Pool. Exh. BSG-2, at 3. Bay State has financed its gas inventory held for future use through the BayNor Arrangement since its approval by the Department in 1982. Exh. BSG-2, at 3-4; Exh. BSG-4. In addition to paying to BayNor the cost associated with the gas inventory itself, Bay State also pays to BayNor an increment that represents BayNor's cost of performing under the agreement, including financing costs and associated fees. Exh. BSG-2, at 4. By its terms, the BayNor Arrangement will expire December 24, 2002. In anticipation of this expiration, Bay State was informed that the fees associated with the letter of credit supporting the BayNor commercial paper would increase significantly, by 90-100 basis points, if the BayNor Arrangement were extended. Exh. BSG-2, at 4. Bay State investigated other potential sources for provision of a letter of credit and determined that current market prices would require the letter of credit to increase by approximately 90-100 basis points. Exh. BSG-2, at 3-4. Bay State calculated the costs of extending the BayNor Arrangement based on the increased costs associated with the letter of credit and compared those costs to the costs that would be incurred using the Money Pool to finance gas inventory costs and found that the total borrowing costs using the Money Pool would be lower. Exhs. BSG-2, at 5-8; BSG-6. Accordingly, Bay State proposes to use the Money Pool as the vehicle for financing its gas inventory costs.

III. BAY STATE'S PROPOSED GAS INVENTORY FINANCING METHOD IS CONSISTENT WITH THE PUBLIC INTEREST AND SHOULD BE APPROVED

A. Bay State's Proposal Will Lower Gas Inventory Finance Charges for Ratepayers

Bay State has demonstrated that the use of the Money Pool will reduce gas inventory finance costs for customers, as compared to use of the previously approved financing vehicle, the BayNor Arrangement. These evaluations include both historical gas inventory finance charges, current financing costs, and expected future costs. As shown in BSG Exhibit-6, using the twelve-month inventory balances for the period May 2001 through April 2002 and applying current financing costs under both the Money Pool and the BayNor Arrangement, gas inventory costs under the BayNor Arrangement would be \$156,080 higher than those using the Money Pool. Page 2 of Exhibit BSG-6 compares the cost of financing inventory through the BayNor Arrangement as compared to the Money Pool in the future. Under this comparison, which utilized recent actual costs, the Money Pool again proved to be the more cost effective financing vehicle, by a total of \$188,193.

Further, the actual interest rates applied to borrowings in the Money Pool for Bay State to date support the Company's estimates of likely savings that will occur as a result of this change in the financing vehicle. See, Exhibit DTE-12.

B. Bay State's Proposal Is Consistent with Department Precedent

The Department's regulations, 220 C.M.R. 6.06, contemplate calculation of "total inventory finance charges" recoverable through the Cost of Gas Adjustment Clause ("CGAC") associated with gas inventory for local distribution companies ("LDCs") based on the existing (or anticipated) financing rate through a trust or other financing vehicle. In a previous instance where an LDC proposed to finance its inventory through cash and short-term debt and apply an external interest rate,¹ the Department directed that company to demonstrate that its preferred financing method was more cost-effective for ratepayers. See, Fitchburg Gas & Electric Light

¹ Bay State does not propose to use a proxy interest rate.

Company, D.T.E. 98-51, at 22 (1998); Fitchburg Gas & Electric Light Company, D.T.E. 99-32 (1999). As demonstrated in Section III.B, above, Bay State has met this standard, by demonstrating that the use of the Money Pool to finance gas inventory is expected to result in savings as compared to the existing BayNor Arrangement.

C. Response to Department Briefing Questions

1. Applicability of G.L. c. 164, §§ 76A and 85

Bay State's petition in this proceeding was submitted, inter alia, pursuant to G.L. c. 164, § 76A, which specifies that the Department "shall have the general supervision of every affiliated company, as defined in section eighty-five, with respect to all relations, transactions and dealings, direct or indirect, with the gas or electric company with which it is affiliated...." Thus, the Department maintains general supervisory authority over the transactions contemplated in this proceeding. Bay State's use of the Money Pool to finance gas inventory will not require execution of a separate agreement, and will be governed by the existing agreement Bay State executed to participate in the Money Pool, the terms of which were reviewed by the Department in D.T.E. 01-75.

Section 85 of G.L. c. 164 defines "affiliated companies" for purposes of Section 76A and authorizes officers and employees of the Department to examine records related to dealings with affiliated entities. Bay State did not file its petition pursuant to Section 85 because this proceeding does not necessarily invoke the need for Department staff to review specific affiliate transactions, since those transactions and the Department's review thereof would occur at a later date.² Further, because the Company's participation in the Money Pool Agreement has previously been approved by the Department and because Section 76A grants broad authority to

² For example, such review may occur in a proceeding conducted pursuant to G.L. c. 164, §§ 93 or 94.

the Department with respect to affiliate transactions, Bay State considered this the appropriate provision under which to request authority.

2. Consistency with Findings in D.P.U. Order 962

The Department also requested that the Company address how its current proposal meets issues addressed in the Department's Order approving the original BayNor Arrangement, D.P.U. 962. Specifically, the Hearing Officer requested that the Company address the benefits ascribed to BayNor's status as an unaffiliated entity. See, D.P.U. 962, at 4-6. As described in Section III.C.1, above, the Department maintains broad authority to oversee affiliate transactions as well as to examine associated books and records pursuant to G.L. c. 164. Further, Bay State's participation in the vehicle through which Bay State proposes to finance its gas inventory, the NiSource Money Pool, was previously reviewed and approved by the Department. See, Bay State Gas Company, D.T.E. 01-75 (2001). The applicable interest charges for Bay State's participation in the Money Pool are readily determinable and recorded, and will be identified in semi-annual CGAC filings, which should allow for relative ease of review by the Department. As a participant, Bay State will borrow from the Money Pool and pay monthly interest equal to the weighted average daily interest rate on (1) short-term external borrowings by NiSource Finance, plus (2) NiSource Finance's earnings on external investments. D.T.E. 01-75, at 3. The cost to borrowers, such as Bay State, is lower than would otherwise be available from external sources. Id. at 6.

As indicated in Exhibit DTE 2, the operation of the Money Pool is also governed by the Securities and Exchange Commission ("SEC") and extension of the Money Pool term will be

subject to review at the SEC.³ Thus, operation of the Money Pool is subject to regulatory oversight on both the state and federal levels.

IV. CONCLUSION

Wherefore, Bay State Gas Company respectfully requests that the Department grant its request for authority to (1) use the existing NiSource Money Pool in place of Bay State's Fuel Purchase Agreement with BayNor Energy, Inc., (2) continue to collect the financing charges associated with its gas inventory through its Cost of Gas Adjustment Clause, and (3) grant such other approvals as it may deem appropriate.

Respectfully submitted,

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³ SEC Rules, 17 C.F.R. 250.52, do not permit the mark-up of interest on funds loaned to affiliates.